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C O N F I D E N T I A L SECTION 01 OF 02 KIEV 000565

SIPDIS

ENERGY FOR LEKIMOFF AND CCALIENDO

E.O. 12958: DECL: 02/10/2016

TAGS: [EPET](#)

SUBJECT: DEPUTY ENERGY MINISTER PROVIDES ADDITIONAL DETAILS ON GAS DEAL

REF: KIEV 534

Classified By: Ambassador. Reasons 1.4 b) and d)

¶1. (C) Meeting with U.S.-funded energy adviser Elkind (protect) and Econ Counselor February 8, Deputy Energy Minister Valeriy Yasyuk defended the January 4 Ukraine-Russia gas deal as the best that Ukraine could achieve at the time. He noted a framework agreement and six other agreements had been signed on January 4. Yasyuk argued the deal, including RosUkrEnergo (RUE) commitments for gas deliveries, provided a stable price for Ukraine for five years. However, he admitted the deal was not ideal and said Ukraine was working on improvements, including a proposed intergovernmental agreement. When energy adviser Elkind noted reports the new joint venture UkrHazEnergo would have access to gas distribution and possibly also upstream development in Ukraine, Yasyuk contended that Ukrainian legal restrictions were sufficient to ensure UkrHazEnergo did not achieve a dominant position in these areas. Yasyuk also defended the low price given to RUE for gas storage, noting Ukraine needed the gas for technical reasons and was having trouble finding enough gas for its storage. End Summary.

THE BEST WE COULD DO

¶2. (C) Meeting with U.S.-funded energy adviser Elkind (protect) and Econ Counselor February 8, Deputy Minister of Fuels and Energy Yasyuk stated the deal provided for a price of USD 95/thousand cubic meters (tcm) for five years. (Note: Presidential chief of staff Rybachuk had told Ambassador earlier Yasyuk had led his ministry's defense of the gas deal against other critics in the Cabinet, and Rybachuk had suggested Embassy meet with Yasyuk.) Yasyuk asserted this was the only price foreseen in the agreement. For 2006, he said, the agreement guaranteed RUE would sell Ukraine 34 billion cubic meters (bcm). Ukraine would obtain the balance of its needs from 20 bcm of domestic production and 22 bcm through its contract with Turkmenistan. For 2007-2011, the agreement provided RUE will provide up to 58 bcm to Ukraine. Yasyuk said the GOU still hoped to sign a new 30-year agreement with Turkmenistan this year, and believed the GOU had some proposals that would induce Turkmenistan President Niyazov to sign during a visit to Kiev later this year. (Note: No dates have been set.) The GOU hoped that if it could get 40 bcm of Turkmen gas through the new agreement, then RUE could provide the balance needed from Kazakhstan and Uzbekistan. In any case, he continued, Ukraine had insurance through its contract with RUE for 58 bcm at USD 95/tcm, and the GOU presumed RUE would be able to obtain that quantity of gas since RUE was willing to make the commitment for 2007 and beyond.

¶3. (C) Elkind asked how the GOU could be sure Ukraine would get even 22 bcm from Turkmenistan this year since GazProm had also purchased gas from Turkmenistan. Yasyuk responded the GOU knew of this agreement with the Russians, but added GazProm vice chair Ryazanov had signed an agreement to ensure the transit of 22 bcm of Turkmen gas in 2006 to Ukraine, including transit of the gas through Kazakhstan and Uzbekistan. Elkind suggested they might have little recourse if a shell company like RUE failed to deliver. Yasyuk said they assumed since GazProm had proposed RUE as the middleman and owned 50% of RUE, it would stand behind RUE. He noted also GazProm had transferred long-term rights to Central Asian gas to RUE, so they were reasonably confident even if Turkmenistan sold gas to Russia instead of Ukraine, the Russians would sell it to RUE. He admitted this was no 100% guarantee and a risk, but said they were working on ways to ameliorate these problems. Yasyuk also recognized there was a valid question how long the USD 95/tcm price would hold, since the agreement did not have a price mechanism like in many other international gas agreements.

DESCRIPTION OF AGREEMENT

¶4. (C) Yasyuk provided a more detailed description of the agreement than that provided by Minister Plachkov (reftel). Yasyuk said there had been seven agreements signed on January 14. The framework agreement, subsequently leaked to the press, provided the basic gas price, transit price and volume structure of the deal. The six other side agreements were as follows:

-- an amendment to an existing agreement between NaftoHaz and GazProm fixing volumes and prices for transit of gas through 2013;

-- two agreements between NaftoHaz and RUE through 2028 on the transit of gas, amended from 2004 agreements, which covered transit of 15 bcm of RUE gas through Ukraine;

-- amendments to a 2004 agreement between RUE and NaftoHaz on gas storage services through 2028;

-- amendments to an agreement between RUE and NaftoHaz on NaftoHaz selling Turkmen gas at the Turkmenistan/Uzbekistan border;

-- an agreement on NaftoHaz purchasing gas from RUE on the Russia/Ukraine border.

Elkind noted Rybachuk had promised that the Energy Ministry would provide a copy of the agreements to the Embassy. Yasyuk said the agreements had been forwarded to the Cabinet and it was up to them to decide what could be released.

DEAL DONE? ALL BUT LICENSE

15. (C) Elkind asked if the deal had been completed. Yasyuk responded that the only outstanding element was the arrangement between RUE and UkrHazEnergo, as it would only become effective when the joint venture obtained an operating license. When Elkind asked about the proposed intergovernmental agreement and whether it would be a precondition for the deal going forward, Yasyuk said he did not think the deal was conditioned on an intergovernmental agreement. This agreement was to take the place of annual intergovernmental protocols; there had been one signed for 2005, but it had never been ratified -- and gas had flowed even though it had not been in effect. The GOU hoped to forward the draft intergovernmental agreement to the Russians by February 13 or 14. Among the terms would be a GOR guarantee of gas balances, as an insurance that RUE would fulfill its obligations. However, Yasyuk admitted, there was a chance the GOR would not agree to this. Yasyuk added that, as far as he knew, NaftoHaz had acted within its powers in signing the January 4 agreement with RUE and GazProm.

UKRHAZENERGO -- FENCED IN?

16. (C) Elkind noted reports that the joint venture UkrHazEnergo was not only authorized to sell gas in Ukraine, but also in its charter was authorized to perform transit, storage, and even exploration for gas. He asked if there was not a danger the joint venture could gain power in many areas of Ukraine's gas market. Yasyuk stated existing laws and anti-trust authorities would have the ability to ensure that UkrHazEnergo did not assume a monopoly position. For exploration, the joint venture would have to compete in tenders, and would have to show its capability to fulfill license terms, just like any other bidder. In general, Yasyuk noted, the GOU was looking at ways to enhance competition in its domestic gas markets.

GAS STORAGE? WE CAN'T GIVE IT AWAY

17. (C) Yasyuk confirmed that RUE would receive gas storage at the low price of USD 2.25/tcm/year, noting that that price had been set in July of 2004. He said Ukraine had trouble, even at that price, in interesting GazProm or RUE in storing their gas in Ukrainian storage facilities, since these were not suitable for putting gas on the spot market, as were facilities in Western Europe. (Note: Yasyuk did not offer a full technical explanation why the Ukrainian facilities were different.) He stated the Ukrainian storage was used primarily to balance gas supply to both Ukrainian consumers and to GazProm's customers in Europe, and it was thus important to Ukraine there was enough gas in storage to make sure the storage would still function, particularly at low temperatures. Thus, he said, Ukraine was offering rock-bottom prices for storage to make sure it had enough gas in its facilities.

18. (C) Bio note: Yasyuk told us he had only been on the job as Deputy Minister since January 4. Previously, he had been a director of the NaftoHaz production subsidiary ChornoMorNaftoHaz. Although he spoke in Ukrainian, he appeared to understand some English.

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